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Backgrounder

Reform of the Corporate Income Tax System

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THE REFORM OF THE CORPORATE INCOME TAX SYSTEM

INTRODUCTION

In May 1985, the government issued a discussion paper on corporate taxes which proposed broadening the tax base and reducing the rates; the aim was to reduce the complexity of the system and promote market-oriented decisions rather than tax-oriented decisions. Changes in the corporate income tax system may be even more needed today, in light of the U.S. Tax Reform.

On 18 July 1986, the Minister of Finance announced an overall review of the Canadian tax system, and on 23 October 1986, he spoke of the decline of the share of corporate taxes in federal revenues. In his 1987 Budget speech, he stated that:

> Our fundamental strategy in reviewing the corporate income tax is to ensure that profitable corporations pay their fair share ...
>
> Cutting back corporate preferences would balance the reduction of corporate tax rates to levels competitive with those in other countries, while providing increased and more stable corporate revenues.(1)

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(1) Canada, House of Commons, Debates, 18 February 1987, p. 3578.

The Corporate income tax is levied on capital income earned by corporations after deductions have been made for allowable costs. There is some discussion among economists about the purpose of taxing capital income and about who bears the burden of this tax. The tax is carried either by shareholders, consumers or wage earners, depending on market conditions and the market structure. If the tax is meant to be borne by the shareholders, what is the justification for taxing capital income at the source rather than at the individual level? The two reasons generally given are: 1) such taxing captures capital income distributed to foreign shareholders; 2) it prevents corporations from creating a loophole by not distributing earnings to shareholders. Taxing both capital income and individual income will result in a double taxation, however, unless there is full integration of corporate and personal income taxes. In addition, retained earnings by corporations are taxed at the corporate rate, which can differ from the individual shareholder's tax rate. Although capital income has been made taxable, other problems have been created, which should be resolved. The Canadian income tax system to some extent addresses these problems.

Reforms of corporate taxes in Canada surface periodically, usually as part of a broader reform of the overall tax system. The Income Tax Act was first completely revised in 1949. After a decade of debate in the 1960s, especially on the treatment of capital gains, the personal income tax and the integration of the personal and corporate taxes, the government revised many provisions of the Act. During the 1970s, some corporate income tax provisions were changed to make allowance for inflation and to give preferential tax rates to manufacturing and small businesses. The capital cost allowance was altered and the investment tax credit was introduced to encourage investment. By the late 1970s, the many tax preferences and tax rates determining the tax liability of a firm had resulted in a very complex system, with different impacts on different industries and even on different firms in the same sector.

This paper will review problems in the current corporate tax system and the proposals for change; it will also examine the current special tax treatment of certain sectors.

DISCUSSION OF TAX REFORM

A. Current Tax System

The percentage of government revenue contributed by each main source has changed considerably since the early '60s. Figure 1 shows the trend for the shares of personal and corporate income tax in total government tax revenue. Personal income taxes went from 39% in 1961 to 54% in 1986 and corporate income taxes went from 20% to 11% during the same period.(2)

This change in tax shares is not the only problem that faces the government in its reform of the tax system. Indeed, 60% of corporations and 46% of profitable firms do not pay corporate income tax. This is because of the variety of deductions and credits introduced to provide incentives to invest and thus create economic activity. In addition, different types of corporations are subject to different rates of income tax, as shown in Table 1. Finally, international comparison is important when dealing with the tax system.

According to the Conference Board of Canada, the tax environment for corporations in Canada is quite competitive internationally. In a recently published study,(3) the Conference Board compared the after-tax cash flow positions of Canadian businesses with what their positions would have been in other tax regimes. The corporate taxes included were income taxes, commodity and sales taxes, capital taxes and others. The comparison was based on representative firms in different manufacturing industries in 14 countries. The Board found that the Canadian tax system was favourable to petrochemicals, steel, machinery and telecommunications, but less so to the newsprint industry - especially since this industry received preferential tax treatment abroad. Overall, Canada's manufacturing industries have more tax advantages than these industries have in such countries as Japan and Germany. Only in newly industrialized countries (Brazil, South Korea and Taiwan) did industries

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(2) Statistics Canada, National Income and Expenditure Accounts.

(3) J. Wanda and T. Tollo, The Competitiveness of Canada's Corporate Tax Structure, The Conference Board of Canada, Report 16-87, February 1987.

Figure 1

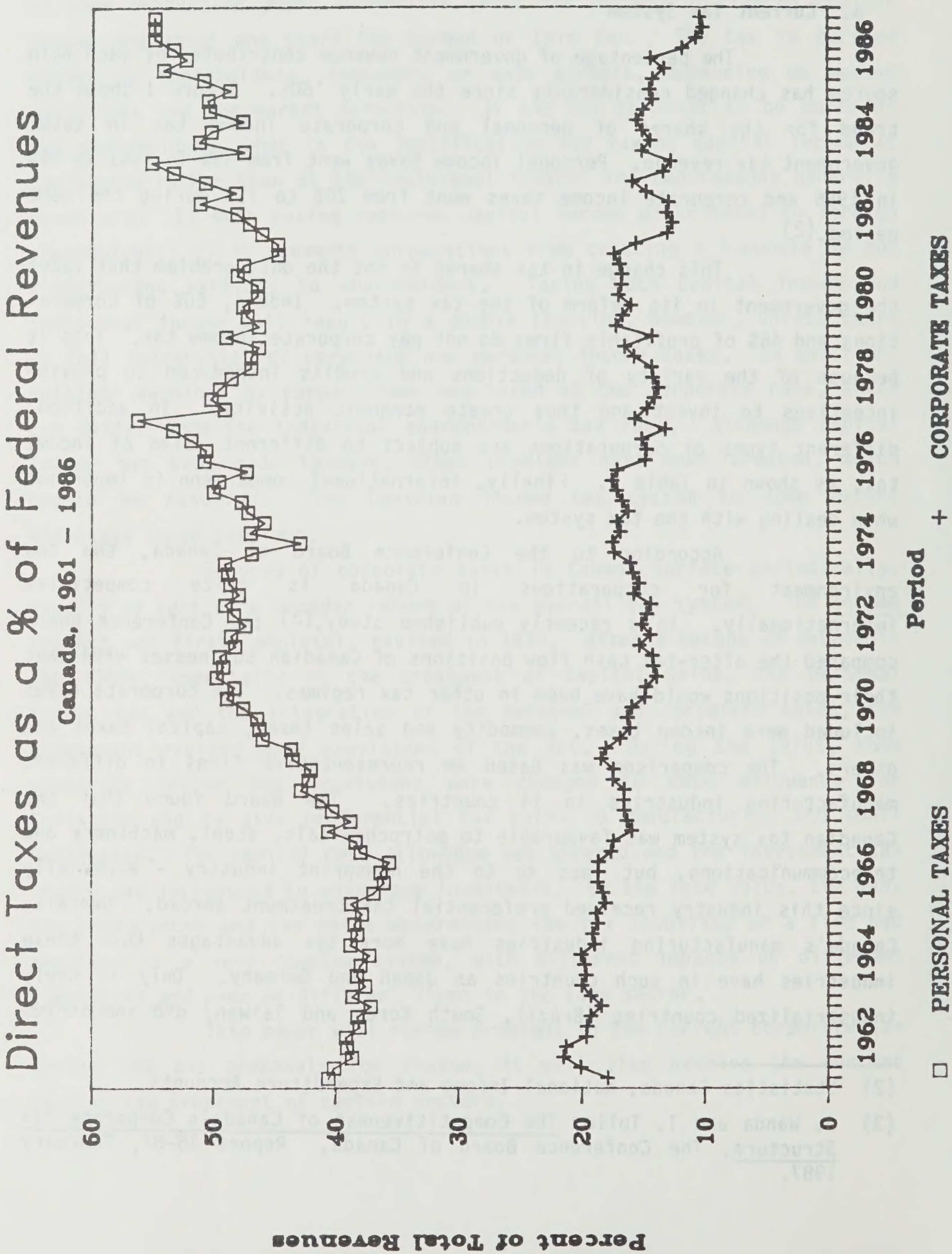
Direct Taxes as a % of Federal Revenues
Canada, 1961 – 1986
Percent of Total Revenues
60
50
40
30
20
10
0
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
Period
□ PERSONAL TAXES
+ CORPORATE TAXES

Table 1

Summary of Corporate Tax Rates Indicated for 1986

			*CCPCs with income eligible for small business deductions	
	General		Active business	
	Mfg.	Other	Mfg.	Other
	per cent			
Federal tax rates:				
Basic federal rate	46.0	46.0	46.0	46.0
Less:				
Provincial abatement	10.0	10.0	10.0	10.0
Small business deduction	--	--	21.0	21.0
Manufacturing and processing deduction	6.0	--	5.0	--
Federal rate before surtax	30.0	36.0	10.0	15.0
5% federal surtax	1.5	1.8	--	--
	31.5	37.8	10.0	15.0
Combined federal and provincial tax rates:				
Income allocated to				
Alberta	42.5	48.8	15.0	20.0
British Columbia	47.5	53.8	18.0	23.0
Manitoba	47.5	53.8	20.0	25.0
New Brunswick	46.5	52.8	19.0	24.0
Newfoundland	47.5	53.8	20.0	25.0
Northwest Territories	41.5	47.8	20.0	25.0
Nova Scotia	46.5	52.8	20.0	25.0
Ontario	46.0	53.3	20.0	25.0
Prince Edward Island	41.5	47.8	20.0	25.0
Quebec	37.0	50.8	13.0	18.0
Saskatchewan	47.5	53.8	10.0	25.0
Yukon Territory	34.0	47.8	12.5	20.0

Source: Robert D. Brown, Corporate Tax Reform: Necessary but Not Sufficient, in Report of Proceedings of the 37th Tax Conference, CTF, November 1985, p. 5-25.

* CCPCs are Canadian controlled private corporations.

fare better. Canada's tax environment is slightly more favourable to industry than that in the U.S., even when the U.S. tax reform and Canada's changes announced in the May 1985 Budget are included.(4)

B. The May 1985 Discussion Paper(5)

In May 1985, the Minister of Finance issued with his Budget a discussion paper on corporate tax reform entitled: The Corporate Tax System: A Direction for Change. This presented the major drawbacks in the current corporate tax system and proposed possible solutions to most of them. Some of these proposals were implemented in the 1986 Budget.

Keeping in mind the tax system's objectives of market efficiency, certainty for corporations, simplicity and stability in revenues, the discussion paper points out that the various tax preferences in the current corporate tax system distort market signals. Effective tax rates (taxes paid expressed as a percentage of profit) vary from firm to firm, and the tax system favours certain sectors and types of investment - machinery for example.

The objectives of the proposals are to reduce specific incentives and tax rates, while keeping the tax revenues from the corporate sector constant. These proposals would reduce market distortions ("reward success rather than effort") and would reduce the bank of unused credits and deductions, which came to $13 billion in 1981 but could well reach $30 billion today,(6) mainly as a result of the last recession. This reduction in the bank of unused credits and deductions would reduce the incentive for trading of tax losses,(7) and thus make government revenues more stable.

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(4) Here, the estimates were made for a representative industry: machinery.

(5) This section is mainly a summary of the paper.

(6) These unused tax credits and deductions are a great source of instability in corporate tax revenues. Also they benefit large firms with a tax history more than start-up firms or those in a cyclical sector, which do not have a tax liability. Hence, the incentive to invest provided by the tax system varies from firm to firm.

(7) Simply stated, tax loss trading arises when a non-taxable firm transfers a portion of its unused deductions and credits to an unrelated tax-liable firm in return for some benefit.

At present, taxes paid by corporations are applied only to a portion of profit. On average, taxable income is only 68.7% of the financial statement income, varying from 47.1% for mining to 93.5% for construction.

To calculate the taxable income on which the corporate tax rate is applied, one must make allowance in the financial statement income (profit), for the following items:

(i) The capital cost allowance (CCA), which is an accelerated write-off for the depreciation of fixed assets.

(ii) The deduction of expenditures on fixed assets for R&D activities and current R&D expenses.

(iii) Other deductions for the mining, oil and gas sectors (which will be examined in more detail later).(8)

When these deductions are greater than the taxable income, the resulting tax loss can be carried back three years or carried forward for up to seven. On any remaining taxable income, a basic federal tax rate of 36% is applied. However, special rates apply for manufacturing and processing corporations (30%), for Canadian-controlled corporations on the first $200,000 (15%), and for Canadian-controlled manufacturing and processing income below $200,000 (10%). In addition to the basic federal corporate taxes, provinces levy their own taxes (see Table 1).

The resulting federal tax payable is then reduced by the investment tax credits for depreciable assets in agriculture, fishing, forestry, manufacturing, processing, resource industries and for certain construction and transportation equipment. The basic rate of reduction is 7% of investment but is increased to 10% for certain provinces and regions, to 20% for the Atlantic provinces and the Gaspé and to 60% for Cape Breton. Tax credits for R&D and exploration costs also reduce the corporate taxes which would otherwise be payable.

All these provisions have benefited specific industries differently. Table 2 shows that the average federal corporate tax

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(8) The 3% of the cost of inventory, which was put in place to compensate for inflation of the inventory replacement costs, was eliminated in the 1986 Budget.

Table 2

Average Federal Corporate Taxes as a Percentage of Financial Statement Income, by Sector

	Ratio of taxable income to financial statement income	Average federal statutory tax rate on taxable income	Ratio of investment tax credit to financial statement income	Average federal tax rate on financial statement income
		(per cent)		
Agriculture, forestry, fishing	86.1	22.1	6.8	11.8
Mining	47.1	34.7	3.1	13.2
Oil and gas	67.2	35.5	2.0	21.8
Manufacturing	69.8	30.3	4.4	16.5
Construction	93.5	23.3	1.9	19.8
Utilities and transport	55.6	33.1	2.3	16.1
Wholesale trade	84.5	28.7	1.1	23.0
Retail trade	86.5	23.9	0.2	20.3
Finance	52.5	32.3	0.3	16.5
Services	89.7	24.6	2.2	19.8
Total	68.7	30.0	2.6	17.9

Source: Department of Finance, The Corporate Income Tax System, A Direction for Change, May 1985, p. 11.

rate varies from 11.8% for agriculture, forestry and fishing to 23% for wholesale trade. On average, the basic corporate tax rate of 36% is reduced to 17.9%.(9)

The average tax rate is a poor indicator of the impact of the current tax system on the level and composition of investment, since it uses past income and current rates. The marginal corporate tax rate on an individual investment project will be a better indication of the incentive to go ahead with the project.(10) The lower the marginal tax rate, the more attractive the particular investment will be. Since tax credits and the rates for write-offs vary for different types of investments, the incentives will differ accordingly.(11)

Making some assumptions as to the rate of return and the taxpaying position of corporations, the Department of Finance estimated that the tax system favours investments in agriculture, fishing, forestry, resource and manufacturing by large corporations, but not investments in retail trade and services. In addition, within each sector, some types of investments (such as heavy equipment, exploration and development in the resource sector) are more favoured than others. Inventories are usually the most taxed, especially as the amount on which they are taxed includes inflation and each firm is affected differently. The distortions in the marginal rates reflect also the lack of investment incentives for start-up firms, as the tax system has no immediate impact on cash-flow. Some firms may face a marginal rate of zero because they have accumulated a reserve of

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(9) These figures are calculated using today's taxes payable for income derived in 1980-81.

(10) If, for example, the marginal (or prospective) investment whose return is just sufficient to cover its costs earns a 10% after-tax rate of return (and has to earn a 15% before-tax rate of return under the tax rules), the marginal tax rate for the particular investment is (15%-10%) divided by the before-tax return (15%) = 33.3%.

(11) The after-tax return generated will tend to be equal for each type of investment (since capital is mobile). Therefore, the before-tax return will differ if marginal rates are different, thus causing the system to be inefficient. The Economic Council of Canada estimates that this inefficiency costs the economy 2% of G.N.P.

unused deductions and credits. However, a recently published study found that the dispersion of the marginal tax rates by industry is smaller in Canada than in the United States, Sweden, the United Kingdom or West Germany.(12)

These differences in the tax treatment by industry and type of investment are considered to be inefficient, even though some sectors and regions benefit from them. Also, the large store of unused deductions, which also benefits some industries more than others, creates a pressure on the system for tax loss trading.(13) The tax system has many effects on financing (debt financing favoured by the system), risk taking, productivity, corporate structure and on the impacts of inflation, since nominal interest payments are deductible. In addition, the benefits in terms of activity and job creation are uncertain.

The Department of Finance has estimated the costs of certain tax expenditures for 1980. Table 3 shows, by industry, the cost of special tax deductions (CCA, resource measures and the inventory allowance) of preferential tax rates and of the investment tax credit. In 1980, these measures cost the federal government $6.6 billion.

In order to reduce the distortions of market signals, the adverse effects of the accumulated unused tax credits and deductions and the complexity of the system, the Minister of Finance announced in his 1986 Budget that the investment tax credit and the corporate tax rates would be

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(12) M.J. Daly, J. Jung, P. Mercier and T. Schweitzer. "The Taxation of Income from Capital in Canada: An International Comparison," in The Canadian Tax Journal, Vol. 35, No. 1, Jan-Feb. 1987. The taxes considered include corporate, personal and property taxes.

(13) These tradings take the form of limited partnerships, term preferred shares, income debentures, rental property etc. for which the Department of Finance have set out rules in order to prevent a substantial tax revenue loss.

Table 3

FEDERAL TAX VALUE OF MAJOR TAX MEASURES, BY SECTOR, 1980[1]

	Tax deductions			Low tax rates		
	CCA	Resource measures	3-per-cent inventory allowance	Small business deductions	Manufacturing and processing	Investment tax credit
	(millions of dollars)					
Resource industries[2]	610	1.265	50	20	75	185
Manufacturing	930	70	250	155	360	370
Construction	65	0	5	165	5	5
Utilities and transport	200	50	10	55	0	50
Trade	120	5	175	440	25	25
Finance	265	30	5	150	0	5
Services	80	0	5	245	15	15
Other	10	10	0	75	0	20
All industries	2,280	1.420	500	1.305	480	675

(1) Tax value refers to the reduction in federal corporate tax revenues arising from the availability of the tax incentive. It is based on what companies claim in the year
(2) Data for agriculture, fishing and forestry are not available.

Source: The Corporate Income Tax System - A Direction for Change, Department of Finance, May 1985.

reduced and that the inventory allowance would be eliminated. The long-term plan is to phase-out the ITC, according to Table 4.

PROPOSED INVESTMENT TAX CREDIT RATES, 1987-1989

	1987	1988	1989
	(per cent of eligible investment)		
Current 7-per-cent rate	5	3	0
Current 10-per-cent rate	7	3	0
50-per-cent rate for manufacturing in Special Investment Tax Credit areas	40	40	40
Research and development	unchanged from current rates of 20, 30 and 35		
Atlantic region	unchanged from current rate of 20		
Cape Breton	unchanged from current rate of 60		
High-cost exploration	unchanged from current rate of 25		

Source: Budget Papers, February 26, 1986, Department of Finance, p.30.

The accelerated CCA would be reduced to a 25% depreciation rate on a diminishing balance basis and the basic corporate federal tax would be reduced from 36 to 29%. The small business rate would fall from 15% to 11%, while the manufacturing and processing rates would fall from 30 to 23% and, for small business, from 10 to 6%.(14)

These changes should help equalize the various average and marginal tax rates that firms at present face. It has been estimated that:

(14) The rate reduction for manufacturing and processing is higher, to account for the higher disadvantage to this industry of the reduced CCA provision.

> such a policy package would result in a substantial reduction in the variation of tax rates among types of assets, industries, methods of finance, and owners, leaving the overall tax rate almost entirely unchanged. Note, however ... that the abolition of the inventory allowance would tend to increase the dispersion in tax rates, whereas the other three proposals [reduction in nominal rates, in accelerated capital cost allowances and the elimination of the investment tax credit] would reduce it.[15]

C. Other Problems with the Corporate Tax System

Many remaining problems are not tackled by the discussion paper.[16] Critics of the corporate tax system give the following examples:

(i) The personal and corporate income taxes are not fully integrated, sometimes resulting in double taxation of profits. Also, the dividend tax credit may result in inequities, since this credit is granted, whether or not the firm pays tax.

(ii) Investment projects are treated differently, depending on the industry, the size of the firm and the type of asset, as we have seen, but also on the financial structure and type of owner.

(iii) Gains and losses are not treated symmetrically, since the former are taxed and the latter do not attract a refundable credit or even an indefinite carry forward provision with full interest.[17] This discourages risky investments and investments by smaller firms not in a tax paying position.

(iv) The taxation of inflation remains. In the current period of low inflation this may have little effect but future periods may carry higher inflation rates. The Department of Finance states that the deductibility of

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(15) M.J. Daly, J. Jung, P. Mercier and T. Schweitzer (1987).

(16) Some of these problems will likely be treated by the upcoming tax reform.

(17) The Economic Council of Canada recommends this proposition: Road Map for Tax Reform: The Taxation of Savings and Investment, 1987.

interest in debt financing reduces the principal in periods of inflation, thus compensating[18] for the taxing of inflated values of inventories. Some have proposed LIFO (last in, first out) accounting for inventories to reduce the taxation of inflation. The Economic Council of Canada recommends that, as long as inflation remains low, a slightly accelerated CCA and an inventory allowance, reflecting the industry's debt/equity position, will make the proper adjustments for inflation. However, in the long-run, a scheme to fully index the tax system to inflation should be implemented.

(v) Tax preferences for manufacturing and processing were implemented to help these industries remain competitive on the international scene, especially with the U.S. The Economic Council of Canada recommends eliminating these preferential rates and allowing the federal basic rate to fall to 25%. Also, the rate for the first $200,000 of active business income should be set at 16 2/3%.

SPECIAL ASPECTS OF THE CORPORATE TAX SYSTEM

Several sectors enjoy special tax treatments, which is one of the major causes of the differences in marginal tax rates for investment projects. This section will examine the present tax provisions for particular sectors: agriculture, manufacturing and processing, the resource industries, and banks.

A. Agriculture

According to the Department of Finance, the average tax rate on profits from agriculture, forestry and fishing is 11.8%, the lowest rate of any sector. The marginal rate is 16.1% (only the resource sector has a lower rate) and is -.7% for small agricultural businesses. This means that the investment is subsidized. The high capital investments, the preferential tax rate for small businesses and certain special tax provisions for

(18) Although the effects are partial and unequal, depending on the industry and the mix of assets and liabilities of the firm.

farming explain these lower rates. These special provisions for agriculture are:

(i) The use of cash accounting, which excludes changes in inventory values, rather than accrual accounting.

(ii) Five-year block averaging of income.

(iii) Flexible livestock industry valuation, whereby one can deduct the cost of livestock or add it to income in one year and deduct it the following year.

(iv) Deferral of income on grain sales.

(v) Deferral of income on forced livestock destruction.

Provisions (ii)-(v) were implemented to provide stability in taxable incomes since farm revenues and expenses are irregular.

B. Manufacturing and Processing

This sector pays an average tax of 16.5% and a marginal tax of 19.6% (6.2% for small businesses). The average rates are more in line with the overall average, according to the Department of Finance. Manufacturing and processing have preferential nominal tax rates and benefit greatly from accelerated depreciation and investment tax credits. The preferential rates were put in place in the 1970s to help the sector compete in international markets, especially the U.S., and because the sector was an important source of employment creation. The reform announced in the discussion paper (especially the reduction of the accelerated CCA) puts an extra burden on the manufacturing and processing sector, even though the tax rates for this industry are reduced more than the tax rates for other industries. In its pre-budget submission to the Minister of Finance on November 19, 1986, the Canadian Manufacturers' Association stated that:

> Our primary concern with this proposal is that taxes payable are increased for manufacturing and processing, and generally reduced for the service sectors. In addition, with the potential elimination of the fast write-off CCA, there will be a further significant cash impact due to higher taxes payable. Given the high levels of capital expenditures which continue to be required for "state of the Art" technology, we believe that these measures are counter-productive.

The C.M.A. adds that if tax reform requires the elimination of the fast write-off CCA, then, in order to restore the balance, the tax rates for manufacturing and processing should be further reduced. The CMA also recommends that R&D tax credits be refundable for all companies in order to encourage R&D expenditures by non-tax-paying corporations.

C. Resource Industries

Several provisions of the Income Tax Act specifically concern the resource sector. These provisions generally recognize the higher risks associated with investments in this area. The average tax rate is low in the mining sector (13.2%) but higher in the oil and gas sector (21.8%),(19) while the marginal tax rates are very low for the overall resource sector (8.5%). In analyzing the marginal tax rates for the oil industry in Alberta, Ethier and Simard(20) found that the marginal rates were negative and stated that:

> The results indicate that the corporation income tax has subsidized, at the margin, acquisition of capital at most production stages over the twenty year period considered. Royalties, on the other hand, have resulted in positive tax rates at the development and extraction stages for the second half of the 1970s.

The special provisions for these industries are:

(i) The resource allowance equal to 25% of resource operating income, net of associated CCA, is deducted from taxable income which mainly compensates for the non-deductibility of provincial royalties and mining taxes for the mining industry. The resource allowance is greater than the amount of provincial mining taxes paid and for the oil and gas industry, the resource allowance does not cover the royalties paid.

(ii) The full deduction of exploration and development expenditures stimulates regional development and reflects the high risks associated with these expenditures.

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(19) The Department of Finance considers that the rate will remain so high only temporarily.

(20) M. Ethier, and D. Simard, Marginal Effective Tax Rates for the Oil Industry in Alberta, 1965-84, Discussion Paper No. 314, Economic Council of Canada, October 1986. The methodology and assumptions used by these authors are different from those of the government discussion paper.

(iii) For mining, the earned depletion allowance (which provides a 1/3 deduction of qualifying expenditures including exploration, development and new mines) is an incentive for exploration and, in combination with flow-through shares, helps raise money. (The earned depletion allowance was phased-out in 1981 for the oil industry and replaced by Petroleum Incentives Payments (PIP) which were themselves terminated and replaced by a new set of incentives in March 1987.)

(iv) The fast capital allowance write-offs for certain types of asset have helped compensate for inflation and maintain a good competitive position.

(v) Flow-through shares are an important means of raising capital for exploration. This provision provides a 100% deduction to the individual investor and, in combination with the earned depletion allowance, is a very attractive instrument for raising capital.

In the context of tax reform, Douglas G. Stoneman, Chairman of the Canadian Petroleum Association, indicated before the House of Commons Committee on Finance and Economic Affairs that:

> This industry is probably riskier than many other industries, so I believe a case could be made that even against the objective of neutralizing incentives, in order to stimulate and cause to happen the activity in the oil and gas industry that needs to happen, there may be a case for some tax preferences to us.(21)

On the other hand, in order to restore the neutrality of the system, the Economic Council of Canada recommended the phasing out of the earned depletion allowances and the provincial processing allowances, in combination with a reduction in tax rates.(22) In addition, the Council stated that the federal resource allowance in lieu of deductions of royalties and mining taxes creates distortions when these two elements are not equivalent. The ECC thus recommends the deductibility of provincial royalties and mining taxes.

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(21) House of Commons, Committee on Finance and Economic Affairs, Issue 35, 19 February, 1987, p. 13.

(22) Economic Council of Canada, Road Map for Tax Reform: The Taxation of Savings and Investment, 1987.

In its extensive investigation on the future of the Canadian economy, the Macdonald Commission recommended that the corporate tax base should be shifted from income to cash flow. This cash flow base (corporate revenues less all costs, with no deduction of interest expenses and full immediate deductibility of capital cost) would adequately protect against inflation. Such a cash flow tax base is proposed by Robin W. Boadway for the resource sector.(23) A full tax loss offsetting mechanism (either a refund or a carry forward of credits with interest) would have to be attached to this new tax base. The existing tax base, which is oriented to revenues, notes Boadway, discriminates against risky investments, but a cash flow base for taxes would be completely neutral.

D. Banks

The banks' income tax system is complicated by certain special provisions. The tax exempt loan substitutes, which took the form of income debentures and term preferred shares financing were implemented in the mid-'70s to facilitate the takeover of foreign controlled companies, especially in the resource area. This provision was extended to small businesses in 1982 but has been eliminated and only outstanding balances still remain. These loan substitutes directly benefited the acquiring corporations, especially those in a non-tax paying position.

The banking sector is allowed to hold deductible loan loss provisions which cannot exceed approximately 1% of assets and these provisions include actual write-offs, revaluation of portfolios and special provisions for sovereign risk debt. In 1986, these loss provisions were partly oil related (34% of total) and partly related to sovereign risk debt (25%).

Banks are facing special federal and provincial capital taxes ($247 million dollars in 1986) and are obliged to hold deposits with the Bank of Canada, at an estimated cost of $222 million. This last provision, however, will be phased out in 1990.

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(23) Robin W. Boadway. Reforming the Corporate Tax System, in Report of Proceedings of the 37th Tax Conference. CTF, November 1985.

CONCLUSION

Under the Department of Finance proposals in the discussion paper of May 1985, many tax preferences for special industries will remain, so that average and marginal tax rates will continue to differ from one industry to another, although these disparities should become less significant.

The changes in tax preferences for corporations will face some resistance. All the groups that spoke on tax reform before the House of Commons Committee on Finance and Economic Affairs, were in favour of the general principles of broadening the base and reducing the rates, but, in order that they should remain competitive, they urged the government not to change or remove the tax preferences.

In examining the impact of the tax system on investments and economic activity, especially on small businesses, the possible implementation of a Business Transfer Tax (BTT) or of another indirect tax to replace the Manufacturers' Sales Tax (MST), and the changes in the personal income tax system have to be taken into account. Also, in overall tax reform, the Minister of Finance may want to increase the burden of taxes on corporations.

Finally, the important question of the unused tax credits and deductions should be resolved partly by the reduction in the corporate tax rates which will lessen their value. The instability of government revenues should be dealt with by the general guidelines announced by the Minister of Finance for tax loss trading between corporations.

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